FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 26 1946
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1945

No. 750

PEOPLE OF THE STATE OF ILLINOIS, ex rel.
ROBERT L. GORDON, Director of Labor,
Petitioner,

vs.

NIGEL D. CAMPBELL, Collector of Internal Revenue,
Respondent.

REPLY BRIEF FOR PETITIONER.

GEORGE F. BARRETT,
Attorney General of the State of Illinois,
208 South LaSalle St., Chicago 4, Ill.,
Attorney for Petitioner.

ALBERT E. HALLETT,
Assistant Attorney General,
Of Counsel.

CHAMPLIN SHEALY COMPANY, CHICAGO — No. 368

INDEX.

PAGE

CITATIONS.

Cases:

Conard v. *Atlantic Insurance Co.*, 26 U. S. (1 Peters) 386, 441, 443 5

Elfast v. *Lamb*, 111 F. (2d) 434 3

Ever Krisp Food Products Co., In re, 307 Mich. 182, 196, 212 7

Ernst v. *Guarantee Millwork Co.*, 200 Wash. 195, 93 Pac. (2d) 404 7

Price v. *United States*, 207 U. S. 492 4

Thelusson v. *Smith*, 15 U. S. (2 Wheat.) 396, 425 6

United States v. *Butterworth Corp.*, 269 U. S. 504 4

United States v. *Emory*, 314 U. S. 425 4

United States v. *Texas*, 314 U. S. 480, 484 ..... 3, 6

United States v. *Waddill Co.*, 323 U. S. 353, 356 5

Statutes:

Internal Revenue Code (26 U. S. C., 1940 ed.), Sections 1400, 1401, 1430 and 3661 2

Section 3466, Revised Statutes (31 U. S. C. 191) 1, 2, 3, 5, 6, 7

Social Security Act (Ch. 531, 49 Stat. 620), Section 801 of Title VIII 2

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1945

No. 750

PEOPLE OF THE STATE OF ILLINOIS, ex rel.
ROBERT L. GORDON, Director of Labor,
Petitioner,

vs.

NIGEL D. CAMPBELL, Collector of Internal Revenue,
Respondent.

REPLY BRIEF FOR PETITIONER.

I.

As in the brief in No. 749, respondent erroneously assumes that the State contends that the United States is not entitled to priority because

> "Congress intended to exclude the federal social security taxes from the scope of Section 3455."

Respondent also erroneously assumes that the State contends that such taxes by the Federal government are not debts within the meaning of Section 3466.

As we make clear under Point I of our reply in case No 749, we do *not* make the contentions above described. What

we *do* contend is that Congress by the enactment of the Social Security Act and related legislation has manifested an intention that the priority of the United States under Section 3466 *shall not apply as against claims of the States for unemployment compensation taxes* exacted under State statutes adopted in accordance with the congressional policy evinced in the Federal statute.

Instead of repeating the argument presented under Point I of the brief for respondent in No. 749, respondent merely incorporates by reference the argument there presented. We likewise here incorporate by reference the reply to be found under Point I of our reply in No. 749.

One additional factor, however, requires further comment. In a footnote respondent points out that $229.91 of its total claims of $1,954.07 (R. 15, 17) represents employee's taxes imposed under Section 1400 of the Internal Revenue Code (Sec. 801 of Title VIII of the Social Security Act) and required to be collected by the employer by withholding such amounts from the wages of the employees. From these provisions and from the further provisions of Sections 1439 and 3661 of the Internal Revenue Code, respondent contends that such amounts constitute a special fund in trust for the United States, are therefore not a part of the general assets of the debtor and are therefore payable to the United States in any event prior to the payment of all other claims.

This does not follow unless it also appears that such sums were in fact collected by the employer from its employees or were in fact withheld from their wages by the employer. There is no allegation or proof that such funds were actually collected by the employer or were withheld by the employer from the wages of its employees, consequently no trust fund existed in this case.

II.

Respondent has simplified the argument under this Point by conceding that Section 3466 is not applicable unless it is shown that the debtor committed an act of bankruptcy and that the only definition of an act of bankruptcy pertinent to the facts in this case is where a debtor has

> "(5) while insolvent or unable to pay his debts as they mature, procured, permitted or suffered voluntarily or involuntarily the appointment of a receiver to take charge of his property."

Respondent also appears to concede that the Director's foreclosure suit sought only a receiver for such personal property as was covered by his lien, and admits that *Elfast* v. *Lamb*, 111 F. (2d) 434, and cases there cited, hold that a receivership in aid of a foreclosure does not constitute an act of bankruptcy, but impliedly challenges these decisions.

Respondent rests for the most part upon the contention that even though the Director's suit started out as a receivership in aid of a foreclosure, it was expanded into a general equity receivership by the court's order which directed the receiver to

> "take charge of the premises and the business, property and assets contained therein located at 1234 North Halsted Street, Chicago, Illinois."

Respondent then cites *United States* v *Texas*, 314 U. S. 480, where a receivership in aid of a foreclosure of a chattel mortgage was expanded so as to bring in all other property of the debtor and this court held that this subsequent action converted the proceedings into a general equity receivership within the scope of Section 3466.

The flaw in respondent's argument is that although the order appointing the receiver did use rather general language, there is no allegation or evidence that any property of the debtor, *other* than that covered by the Director's lien (which extended to all personal property used by the debtor in the prosecution of its business), was actually brought into the receivership. Since the debtor corporation could only own personal property appropriate to the prosecution of its business and there is no suggestion that it owned any realty, it must be presumed that the only property turned over to the receiver was that covered by the Director's lien.

Thus, despite the general language of the order appointing the receiver, the receivership in fact continued as it had commenced, merely a receivership in aid of a foreclosure, which, under the cases, does not constitute an act of bankruptcy.

Respondent concedes that the cases of *United States* v. *Emory*, 314 U. S. 425; *Price* v. *United States*, 207 U. S. 492; and *United States* v. *Butterworth Corp.*, 269 U. S. 504, cited by it, were all receiverships instituted by unsecured general creditors. These cases are therefore not pertinent to the issue here presented.

III.

In answer to our contention that the lien of the Director was so specific and so far perfected as effectively to exclude the funds in question from the estate of the debtor, respondent first contends that the decision of the Supreme Court of Illinois was based upon the facts in this case and is conclusive upon this court as a determination of a matter of State law.

Although, as respondent points out, the Illinois court did in the beginning of its opinion state the facts in both

cases, it is likewise true, as we state in our original brief (p. 41), that the court in passing on this issue relied entirely upon the facts in the *companion* case and does not in any way mention the facts in *this* case. Thus it is obvious that the Supreme Court of Illinois did *not* actually adjudicate this issue with respect to the facts of the case at bar.

The question of whether or not the lien was so specific and so far perfected as to exclude the funds in question from the estate of the debtor and thus to render inapplicable the provisions of Section 3466, is not a matter of *State* law; it is a matter of *Federal* law. The court's remark (R. 55) to the effect that it deemed this Court's language in *United States* v. *Waddill Company*, 323 U. S. 353, as conclusive upon it in this case, indicates that it was considered to be a *Federal*, not a *State* question, and one to be determined under the law laid down by the *Federal* courts.

As this Court, in the *Waddill* case, *supra*, at page 356 said:

> "But it is a matter of *Federal* law as to whether a lien created by State statute is sufficiently specific and perfected as to raise questions as to the applicability of the priority given the claims of the United States by an act of Congress." (Italics added.)

We therefore submit that this Court is not precluded from examining and passing upon the propriety of this ruling by the Supreme Court of Illinois.

Although respondent concedes that this Court has repeatedly held that Section 3466 is not applicable with respect to property previously mortgaged (on the theory that the mortgaged property has passed to the mortgagee and is therefore no longer a part of the estate of the debtor); and concedes, as this Court said in *Conard* v. *Atlantic Insurance Co.*, 26 U. S. (1 Peters) 386, 441, 443, that

> "It has never been decided by this Court, that the priority of the United States will divest a specific lien, attached to a thing, whether accompanied by possession or not."

respondent urges that this Court hold that *in no event* can the priority of the United States under Section 3466 be defeated *even by a specific and completely perfected lien*, and seems to imply that this super-priority should even be so far extended as to defeat the rights of mortgagees under previously executed mortgages.

This conclusion follows, respondent says, from the fact that Section 3466

> "is all inclusive and on its face admits of no exception to the priority of claims of the United States in the distribution of an insolvent estate."

The basic flaw in this argument, as this Court points out in *Thelusson* v. *Smith*, 15 U. S. (2 Wheat.) 396, 425, is that

> "The United States are to be first satisfied; but then it must be out of the debtor's estate."

The cases hold, as this Court noted in *United States* v. *Texas*, 314 U. S. 480, 484, that

> "mortgaged property passes to the mortgagee and is no longer a part of the estate of the mortgagor."

To hold otherwise would destroy the stability of our entire financial system, which is based upon the validity of previously executed mortgages as against all subsequent claims of whatsoever nature.

This same proposition applies to specific and perfected liens upon personal property. All that the debtor owns, even though he may be allowed to continue in the possession of the property, is an equitable interest in the value of the property after the payment of the claim secured by the lien.

While, as has been noted, *this* Court has always reserved decision as to whether a specific and perfected lien (excluding mortgages) would so operate to exclude the property covered by the lien from the estate of the debtor and thus, as to the property so excluded, defeat the Federal government's claim to priority under Section 3466, this exact issue has been decided adversely to the United States by the Supreme Court of Michigan in the case of *In re Ever Krisp Food Products Co.*, 307 Mich. 182 (1943), repeatedly cited by respondent in its brief. There, in holding that certain liens of the city and county for personal property taxes were specific and perfected and therefore defeated the claim of the United States to priority under Section 3466, that court, at page 196, said:

> "If a Federal tax lien cannot be displaced by a later tax lien imposed by State law, *a fortiori* reason indicates that a *specific and perfected tax lien* imposed by State law should not be displaced by a later priority claim (not a lien) asserted under Federal authority.
>
> "* * * The value of the property at all times is the value less the amount of any specific perfected liens. The property therefore passes to the receiver burdened with the city and county liens, its value as a property reduced by the amount of those specific perfected liens."

And concluded at page 212, that:

> "These city and county tax liens are superior to the claim of the United States for priority as to social security taxes and capital stock taxes."

Another State court decision on this point is *Ernst* v. *Guarantee Millwork, Inc.*, 200 Wash. 195, 93 Pac. (2d) 404, where the Supreme Court of Washington held that the claims of the United States to priority under Section 3466 for social security taxes were defeated by a specific and perfected lien of the county for personal property taxes.

We submit that this court should hold that the claim of the State of Illinois was so specific and so far perfected as effectively to exclude the funds in question from the estate of the debtor, and that by reason of such exclusion the priority of the United States could not and did not apply to such funds.

CONCLUSION

In view of the foregoing, we submit that the decision of the Supreme Court of Illinois is erroneous and should be reversed by this Court.

Respectfully submitted,

GEORGE F. BARRETT,
Attorney General of the State of Illinois,
Attorney for Petitioner.

ALBERT E. HALLETT,
Assistant Attorney General,
Of Counsel.